



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

ASSISTANT DISTRICT COUNSEL

FROM: Deborah Butler
Assistant Chief Counsel (Field Service) CC:DOM:FS

SUBJECT: Substance Over Form

This Field Service Advice is a reconsideration of a previous Field Service Advice issued on October 29, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

A	=
B	=
C	=
CC	=
L	=
o	=
date a	=
date b	=

[REDACTED]

date c	=
date d	=
date e	=
y	=
p	=

ISSUE: Whether litigating hazards exist in arguing that A's sale of the assets to B is in substance a distribution of those assets from B to A, followed by a capital contribution from CC to B, in light of the Tax Court's opinion in *Turner Broadcasting System, Inc. v. Commissioner*, 111 T.C. 315 (1998).

CONCLUSION: [REDACTED]

FACTS:

Background

This case involves a transaction in which A may attempt to effectively claim the losses on the sales of the Distributed Assets twice: once in selling the B stock (since A's stock basis in B would not be reduced by losses on the sale of the Distributed Assets) and a second time in later selling the Distributed Assets (since section 267 provided that A increased its basis in the Distributed Assets by the amount of the losses that B recognized on B's sale of the Distributed Assets to A).

Facts -- in general

A, the parent corporation of a consolidated group, wholly owned a subsidiary, B. C, a corporation unrelated to A, wanted to acquire B, but objected to purchasing certain unwanted assets held by B and its subsidiaries. B was engaged in the p business, and state regulatory rules required B to maintain certain surplus balances. These state regulatory rules, which restricted B's ability to make distributions, precluded B from making an outright distribution of the Distributed Assets to A.

A, C and CC (a subsidiary of C) reached an agreement on date d for A to sell its stock in B to CC -- without the Distributed Assets -- with economic effect as of date c. This stock purchase agreement between A, C and CC contemplated that B and its subsidiaries (hereinafter referred to as just "B") were to "sell" the Distributed

Assets to A before date a, and A was to sell its stock in B on date b. While the agreement actually provided that A was either to sell the Distributed Assets or transfer the Distributed Assets, not only did state regulatory rules restrict B's ability to distribute the Distributed Assets (as previously indicated), but the sales agreement to sell the B stock also provided that B could not distribute amounts that B received in selling the Distributed Assets to A. The sales agreement also required B to have the permission of C to pay a distribution, and indicated that B could not make a distribution to the extent it could lower B's o ratings.

A, C, and CC structured the deal by agreeing to a "Base Purchase Price" for the B stock. This Base Purchase Price reflected the value of the B stock without the Distributed Assets. A, C and CC then agreed to further increase this Base Purchase Price by amounts arising from B's "sale" (rather than distribution) of the Distributed Assets ("Excess Purchase Price" or "Excess Purchase Price Amount"). In form, B was to "sell" these Distributed Assets to A, and consequently, B was to hold the "cash proceeds" from these "sales" of the Distributed Assets which were then to factor into the amount of the Excess Purchase Price that CC would pay to B. Or, in other words, CC would "pay" an Excess Purchase Price to essentially "purchase" the "cash proceeds" that B received from A in "selling" the Distributed Assets to A. CC also agreed to pay A interest on these cash proceeds held by B.

Although B was to sell the Distributed Assets to A, A did not have sufficient cash to purchase the Distributed Assets. Consequently, A negotiated short-term loans on date e to make the purchases. According to the credit agreements for these loans, A received the loans on the condition that A use the loan proceeds solely to acquire the Distributed Assets (or to refinance certain Distributed Assets purchased) and to repay these loans on the date on which B was sold to CC. The credit agreement also required B to retain liquid assets equal to the outstanding debt balance.

Between date d and date b, B "sold" Distributed Assets having a value of y to A. The "sales" of the Distributed Assets would not have occurred but for the agreement for the sale of A's stock in B to CC. A also requested permission from the state to resell the Distributed Assets to B in the event the sale to CC was not consummated.

LAW AND ANALYSIS :

Where the substance of a transaction does not coincide with the form chosen by the parties, the transaction should be taxed in accordance with its substance. *Gregory v. Helvering*, 293 U.S. 465 (1935). The substance over form inquiry involves determining whether the labels of the transaction match the economic substance of the transaction as a whole. *J.E. Seagram Corp. v. Commissioner*, 104 T.C. 75 (1995). The meaning of a transaction may be more than its separate parts and the transaction must be viewed in light of the particular circumstances.

[REDACTED]

Gregory v. Commissioner, 69 F.2d 809 (2d Cir. 1934); aff'd 293 U.S. 465 (1935). A transaction can be recharacterized where the form of the transaction does not match its substance and does not reflect the real rights and obligations of the parties. See *Estate of Schneider v. Commissioner*, 88 T.C. 906 (1988).

In order to recharacterize the transaction, there must be a logically plausible alternative explanation that accounts for all the results of the transaction. The explanation may combine steps, but if it invents new ones, courts have refused to apply the step transaction doctrine. *Esmark, Inc. & Affiliated Cos. v. Commissioner*, 90 T.C. 171 (1988). Even if alternative explanations are available to account for the results of a transaction, a court will not disregard the form of a transaction if it accounts for the transaction at least as well as alternative explanations. *Esmark, supra*.

In *Turner Broadcasting System, Inc. v. Commissioner*, 111 T.C. 315 (1998), Turner Broadcasting System, Inc. ("Turner Broadcasting") acquired MGM/UA Entertainment Co. ("MGM") stock at the same time MGM sold all of its stock in its wholly owned subsidiary, United Artists Corp. ("UA") to Tracinda Corporation ("Tracinda") at a loss. Before this transaction, Tracinda owned a controlling interest in the MGM stock. Tracinda paid for the UA stock with the cash it received from Turner Broadcasting in the MGM stock purchase. MGM used some of the money received from Tracinda to pay off bank debt. When Turner Broadcasting acquired the MGM stock, MGM loaned Turner Broadcasting approximately 107 million dollars.

The government argued that the transaction's substance was a distribution of UA stock in redemption of MGM stock, followed by a capital contribution from Turner Broadcasting to MGM equivalent to the value of UA. (The portion of MGM stock equal in value to the UA stock was redeemed by MGM in exchange for the UA stock.) The Tax Court held in favor of the petitioners and ruled that the form they adopted should determine their tax consequences. The Tax Court held that the loss was recognized by MGM and was available to the Turner Broadcasting Group.

The Service will continue to analyze when a transaction will be taxed in accordance with its substance and not its form.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

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If you have any further questions, please call 202-622-7930.

cc: Regional Counsel CC:NER
Assistant Regional Counsel (LC) CC:NER